United States Court of Appeals

for the Second Circuit

APPELLEE'S BRIEF

75-7095

To be argued by
MELVYN I. WEISS

United States Court Of Appeals

For the Second Circuit

JAY HANDWERGER,

Plaintiff-Appellee,

against

CHARLES GINSBERG, JR., DAVID WEINTRAUB, ABRAHAM WEINTRAUB, ALAN R. CARP, JAMES P. SANDLER, A. THEODORE BARRON, STANLEY FROST, EDWARD GINSBERG, NOAH GOLDBERG, JOHN W. HURLEY, ALLAN LAZAROFF, SANFORD L. ROSENBERG, HEINZ SCHNEIDER, ROBERT B. SEGAL, MARTIN UNGER, AARON WEINTRAUB, HARRY WEINTRAUB, SANITAS SERVICE CORPORATION,

Defendants,

ARTHUR ANDERSEN & CO.,

Defendant-Appellant.

Appeal from the United States District Court for the Southern District of New York

BRIEF FOR PLAINTIFF-APPELLEE JAY HANDWERGER

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STATEMENT OF ISSUES

This appeal pursuant to 28 U.S.C. §1291 puts in issue whether the District Court properly exercised its broad discretion in conditionally certifying a class of purchasers of common stock and convertible debentures of defendant, Sanitas Service Corporation ("Sanitas") during the period September 21, 1972 through April 13, 1973 during which period it is alleged defendants issued false and misleading statements with regard to Sanitas, wherein defendants represented that a sham sale of a Sanitas division would insulate Sanitas from further losses arising therefrom notwithstanding the fact that further losses of nearly $3 million were imminent and admitted less than four months after the closing of the sham sale.

Plaintiff-appellee, Jay Handwerger ("Handwerger") has requested the appeal be dismissed as being from a non-final order.

In the event the court accepts jurisdiction over the appeal, Handwerger submits that the court below properly held that he is an adequate class representative and that there are no conflicts of interest which would disqualify him. The other contentions of defendant-appellant, Arthur Anderson & Co. ("Andersen") were not raised below and Handwerger contends should not be considered on this appeal. In the event this court does consider these newly raised issues, Handwerger contends that the Supreme Court acted within the scope of the authority granted it by the Rules Enabling Act, 28 U.S.C. §2072 in adopting Rule 23; that the notice and adequacy of representation requirements of Rule 23 comply with the constitutional mandate of due process; and that the complaint sets forth a meritorious claim against Andersen which may not be dismissed on the basis of the existing record.

United States Court Of Appeals

For the Second Circuit

No. 75-7095

JAY HANDWERGER

Plaintiff-Appellee,

against

CHARLES GINSBERG, JR., DAVID WEINTRAUB, ABRAHAM WEINTRAUB, ALAN R. CARP, JAMES P. SANDLER, A. THEODORE BARRON, STANLEY FROST, EDWARD GINSBERG, NOAH GOLDBERG, JOHN W. HURLEY, ALLAN LAZAROFF, SANFORD L. ROSENBERG, HEINZ SCHNEIDER, ROBERT B. SEGAL, MARTIN UNGER, AARON WEINTRAUB, HARRY WEINTRAUB, SANITAS SERVICE CORPORATION,

Defendants,

ARTHUR ANDERSEN & CO.,

Defendant-Appellant.

Appeal from the United States District Court for the Southern District of New York

Preliminary Statement

This is an appeal by one defendant, Arthur Andersen & Co. ("Andersen") pursuant to 28 U.S.C. §1291 from a decision and order of Hon. Henry F. Werker, D.J. entered January 2, 1975 (59A-64A)[1] which held, pursuant to Rule 23, that this case may conditionally proceed as a class action on behalf of all persons who purchased securities of defendant Sanitas Service Corporation ("Sanitas") during the period from September 21, 1972 through April 13, 1973 ("class period"). Of the 19 named defendants, 18 of whom opposed plaintiff's motion for class determination, only Andersen has taken an appeal.

On January 31, 1975, the same day Andersen filed its notice of appeal herein, it also noticed a motion before Judge Werker for an order of certification pursuant to 28 U.S.C. §1292(b).

1. Numbers with suffix "A" refer to pages of the Joint Appendix

Plaintiff-appellee, Jay Handwerger ("Handwerger") has opposed Andersen's motion for certification of an interlocutory appeal. Judge Werker has not decided Andersen's motion for certification, and by letter dated March 27, 1975 Andersen requested that Judge Werker hold in abeyance its motion until this Court acts on the instant appeal.

On March 14, 1975 Handwerger moved to dismiss Andersen's appeal in this Court on the ground that the appeal was from a non-final order. Handwerger's motion to dismiss the appeal was scheduled for argument on April 1, 1975. On March 25, 1975 Andersen moved to have Handwerger's motion to dismiss the appeal argued at the same time as the appeal, and by order dated March 27, 1975 Judge Timbers ruled that Handwerger's motion to dismiss shall be heard by the panel hearing this appeal. Judge Timbers' order directed Handwerger to include argument on the jurisdictional question in his brief. Handwerger's motion for reconsideration was denied on April 4, 1975.

This Court is respectfully requested to take judicial notice that an action was commenced on April 10, 1975 in the United States District Court for the District of Columbia, entitled "Securities and Exchange Commission v. Sanitas Service Corp., et al." alleging the same misrepresentations and omissions alleged in the complaint herein, among others.

Statement of the Case

The action is brought under Section 10(b) of the Securities Exchange Act of 1934, 15 U.S.C. §78j(b), Rule 10b-5 promulgated by the Securities and Exchange Commission thereunder and common law principles, Complaint ¶2.(2A). Handwerger has sued on behalf of himself and a class consisting of all persons who purchased securities of Sanitas during the class period.

Complaint ¶7-11, (4-5A)[2] The defendants include Sanitas, its officers and directors during the relevant period and Andersen, Sanitas' auditor during the class period.

The complaint alleges that the defendants entered into a conspiracy to issue false and misleading statements concerning Sanitas, artificially inflate the market price of Sanitas securities during the class period, and to cause the class members to pay artificially inflated prices for Sanitas securities.

More specifically, it is alleged that the defendants entered into and improperly reported a sham transaction whereby Sanitas purported to sell its unprofitable Economy Linen Service Division ("Economy") to certain officers and directors of Sanitas thereby creating the impression that the sale would relieve Sanitas of further losses arising from Economy, Complaint ¶12(a)(5A). It is further alleged that defendants failed to disclose that (1) the purchaser of Economy was a *limited* partnership whose general partner was a corporation without substantial assets, Complaint ¶12(b)(5A); (2) the provision for loss reported on the sale of Economy in the amount of $2,729,248 was inadequate, Complaint ¶12(c)(6A); (3) that Sanitas made a so-called "working capital advance" of $1,000,000 to Economy, which sum equalled the cash down payment received by Sanitas on its "sale" of Economy. Complaint ¶12(d)(6A); and (4) that there was serious doubt as to the collectibility of the promissory note to be received by Sanitas in consideration of the sale of Economy in the amount of $1,615,569 or the recovery of the $1,000,000 working capital advance, Complaint ¶12(e)(6A). In fact Sanitas actually sustained a loss of more than $5,600,000 in connection with its disposition and liquidation of Economy, Complaint ¶12(c)(6A).

2. The class was defined in the complaint as being all purchasers of Sanitas securities during the period June 30, 1972 through June 30, 1973. It appearing that the misrepresentations and omissions alleged were originally made by letter dated September 21, 1972 (37A) and partially rectified in a press release dated April 13, 1973 (40A) the class definition was altered accordingly. The decision and order of Judge Werker conditionally certified a class of purchasers from September 21, 1972 to April 13, 1973.

The September 21, 1972 letter (37A-39A) and the 1972 Annual Report (25A-3) stated that Sanitas was selling Economy, and in connection therewith advised:

> "The decision to sell Economy, while penalizing our net results for the previous year will have a very favorable effect on our earnings for this year" (25A-3b)

and

> "With prospects for expansion on a national scale so positive, I think you will agree that the subordination of these opportunities to prolonged involvement with Economy was not in the best interest of shareholders. We have, accordingly, entered into an Agreement which gives Sanitas the right to sell to a partnership including Sanitas officers and directors, substantially all assets of Economy for $2,615,569, their net tangible asset value. The sale will be consummated on or before January 5, 1973 but is effective as of July 1, 1972." (38A)

Neither the September 21, 1972 letter nor the 1972 Annual Report disclosed that the partnership was only a limited partnership whose general partner was a newly formed corporation with nominal assets[3], or that Sanitas continued to bear a significant risk and would most probably sustain a further material loss with respect to Economy for which no reserve was established.

The Agreement was actually a "put" whereby the partnership was a purchaser of last resort in the event no independent buyer could be found for Economy. The "sale" to the partnership closed December 22, 1972. Notwithstanding the date of the Agreement, and the date of the consummation of the sale, the defendants treated the transaction as being effective July 1, 1972 and thereby sought to eliminate the adverse Economy results[4] from the Sanitas Financial Statements after June 30, 1972.

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3. That it was a limited partnership was buried at the end of another separate document, Sanitas' proxy statement (25A-4,5).

4. It was not disclosed that Economy sustained substantial operating losses after June 30, 1972.

The Agreement to sell Economy to the partnership was dated September 14, 1972, the same date that Andersen "signed off" its opinion on the 1972 Sanitas Financial Statements.

On April 13, 1973, less than four months after the closing of the "sale" of Economy to the limited partnership, Sanitas was required to establish an additional $2,900,000 in reserves for losses arising out of the uncollectibility of the purchase price and the proposed disposition of the "limited purpose real property" leased to the partnership (40A).

The sham nature of the transaction is further underscored by the subsequently disclosed fact that the partnership agreed to pay to Sanitas any profit realized by the partnership on any resale of Economy. Sanitas officers and directors who participated in the transaction owned hundreds of thousands of shares of Sanitas stock, many of which were pledged to secure bank loans which would have been in jeopardy had Sanitas' securities market value dropped.

Handwerger lives near Albany, New York. He is an attorney who has served as counsel to the State University Construction Fund since 1962(16A). Prior to 1962 he was employed as an associate in two law firms in New York City (14A-15A)[5]. Handwerger purchased $5,000 of Sanitas convertible subordinated debentures on about January 23, 1973. Those debentures were convertible into 625 shares of Sanitas common stock. At the time the class motion was pending in this action (October 1974) there was no meaningful market for Sanitas debentures or common stock. (57-58A).

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5. The inuendo attaching to the statement at page 6 in Andersen's Brief that "Plaintiff has been a lawyer for sixteen years, employed successively by two law firms known to be active in securities litigation, primarily representing plaintiff in class actions and 10b-5 cases" is unbecoming to Andersen or its esteemed counsel. Handwerger has not been employed by those firms for thirteen years and neither firm has any involvement in this litigation. This is the only stock fraud action ever commenced by Handwerger.

Handwerger has brought this action to recover damages arising out of statutory and common law fraud. To the extent he, as a purchaser of convertible debentures, was defrauded, he stands in precisely the same position as every other purchaser of securities of Sanitas during the class period. Identical written false and misleading statements were directed to all such purchasers. The same omissions artifically inflated the market price of all Sanitas securities during said period, and disclosure of the true facts similarly has depressed the market of all its securities.

POINT I

HANDWERGER'S MOTION TO DISMISS THE APPEAL SHOULD BE GRANTED. THIS COURT SHOULD DECLINE JURISDICTION TO HEAR AN APPEAL FROM A NON-FINAL ORDER, WHERE NO EXCEPTIONAL CIRCUMSTANCES ARE SHOWN.

28 U.S.C. §1291[6] provides that an appeal may only be taken from a final decision. Andersen has acknowledged that the order below should not be considered a "final order" within the meaning of 28 U.S.C. 1291, or even the exception thereto created by *Herbst* v. *International Telephone & Telegraph Corp.*, 495 F.2d 1308 (2d Cir. 1974), in moving before Judge Werker for an order certifying an interlocutory appeal pursuant to 28 U.S.C. §1292(b).

Class determinations pursuant to Rule 23, which are continually subject to modification and review by the trial court are not treated as final decisions unless there are exceptional circumstances not present here. Accordingly, Andersen may not seek review of the order granting class status. *General Motors* v. *City*

6. 28 U.S.C. §1291 "Final decisions of district courts.
The court of appeals shall have jurisdiction of appeals from all final decisions of the district courts of the United States, the United States District Court for the District of the Canal Zone, the District Court of Guam, and the District Court of the Virgin Islands, except where a direct review may be had in the Supreme Court."

of New York, 501 F.2d 639 (2d Cir. 1974); *Kohn* v. *Royall, Koegel & Wells*, 496 F.2d 1094 (2d Cir. 1974). This final judgment rule is grounded in logic and should continue in force. As this Court has stated in *Kohn* v. *Royall, Koegel & Wells*, *supra*, 496 F.2d at 1101:

> "The final judgment rule is a salutory principle of long standing duration (citing authority). At a time when our appellate calendars are overflowing, the incisive words of Mr. Justice Frankfurter are particularly worthy of repetition:
>
> > 'Finality as a condition of review is an historic characteristic of federal appellate procedure. It. . . has been departed from only when observance of it would practically defeat the right to any review at all. Since the right to a judgment from more than one court is a matter of grace and not a necessary ingredient of justice, Congress from the very beginning has, by forbidding piecemeal disposition on appeal on what for practical purposes is a single controversy, set itself against enfeebling judicial administration. Thereby is avoided the obstruction to just claims that would come from permitting the harassment and cost of a succession of separate appeals from the various rulings to which a litigation may give rise, from its initiation to entry of judgment. To be effective, judicial administration must not be leadenfooted. *Cobbledick* v. *United States*, 309 U.S. 323, 324-325 (1940).

In adhering to the final judgment rule, the court does not deny the defendant a forum, since the District Court retains the power to reconsider class status as the action proceeds and appeal is available at the end of the case when a final judgment is entered. In *General Motors*, supra, Chief Judge Kaufman stated:

> "Unlike the rulings in *Cohen* and *Eisen*, Judge Carter's determination to permit the City's action to proceed as a class action is very much 'tentative,' subject always to reconsideration as the cause of action unfolds. We noted in

Green v. Wolf Corp., 406 F.2d 291, 298 (2d Cir. 1968) *cert. denied*, 395 U.S. 977, 89 S.Ct. 2131, 23 L.Ed. 2d 766 (1969):

> 'Rule 23 now emphasizes the flexibility which a trial court exercises in the management of the action. . . . It is this flexibility which indeed enables us to view liberally claims which assert a right to a class action. . . at the early stages of the litigation."
> General Motors v. City of New York, supra, 501 F.2d at 646-47.

The administrative necessity for the final judgment rule and the provision of Rule 23 that the trial judge may review and modify a class determination at any time reinforce the applicability of the final judgment rule to orders entered pursuant to Rule 23.

Andersen contends that the Order is appealable under *Herbst* v. *International Telephone and Telegraph Corp., supra.* However, a subsequent decision by this Court, *Kohn* v. *Royall Koegel & Wells, supra,* reaffirms the final judgment rule by emphasizing that:

> "Aside from *Eisen III, supra,* with it rather exceptional circumstances, no circuit. . . had permitted an appeal from an order granting class standing until we did so. . . in *Herbst. . .* " (*Kohn, supra,* p. 1099).

Kohn limited the *Herbst* decision by distinguishing it and narrowly construing it; this Court continued the narrowing process in *General Motors* v. *City of New York, supra.* It is not surprising that the court has limited *Herbst,* for as indicated in *Kohn, Herbst* runs counter to established appellate decisions; also, two of the three judges on the *Herbst* panel had "grave doubts" or "persistent perturbation," about the appealability of the order there granting class action status, and concurred primarily because of the pendency of *Eisen* v. *Carlisle & Jacquelin,* 417 U.S. 156 (1974), then before the Supreme Court.

Herbst v. International Telephone & Telegraph Corp., supra, 495 F 2d at 1325 (Mulligan, J., concurring), 495 F. 2d at 1317 (Danaher, J., concurring).

As to any contention that *Eisen* v. *Carlisle & Jacqueline* 417 U.S. 156 (1974), enlarged the scope of the appealability of such orders, this Court has said:

> "[Eisen did not broaden] the parameters governing the appealability of orders granting class action status. To the contrary, we find in Eisen a reaffirmation of the exceptional circumstances required to justify departure from the 'final judgment' rule – circumstances not present in this case." General Motors v. City of New York, supra, 501 F.2d at 646.

However, even if *Herbst* retained some measure of vigor, it still would not support acceptance of the instant appeal by this Court. Judge Lumbard's opinion in *Herbst* applied a tripartite standard to determine whether such an order was appealable:

> "(1) Whether the class action determination is fundamental to the further conduct of the case;
>
> (2) Whether review of that order is separable from the merits;
>
> (3) Whether that order will cause irreparable harm to a defendant in terms of time and money spent in defending a huge class action." *Id.* at 1312; *Kohn V. Royall, Koegel & Wells, supra,* at 1098; General Motors v. City of New York, *supra,* at 644.

As demonstrated, Andersen's appeal is not maintainable under any of the three criteria established there.

The first element takes into consideration whether the action will be further prosecuted even if a class order is vacated. *Herbst* indicates that where the damage sustained by plaintiff individually is sufficiently substantial, so that there is a likelihood that the action will continue in any event, an appeal will not lie under

the "fundamental to further conduct of the case" exception to the final judgment rule. See also *Shayne* v. *Madison Square Garden Corp.*, 491 F.2d 397 (2d Cir. 1974). Handwerger's claim is substantial, since his damages approximate $5,000, and he fully intends to continue the prosecution of this action.

This Court refused to review a denial of class determination in *Stull* v. *Pool*, 74-1772 (maximum loss of $7500) and the Fifth Circuit refused to review such a decision where the loss was $3322, *Gosa* v. *Securities Investment Co.*, 449 F.2d 1330 (5th Cir. 1971), because said losses were considered sufficiently substantial to warrant continuation of the litigation.

The second *Herbst* exception to the final judgment rule requires that an appeal from a class action determination not raise any questions going to the merits of the case. *Herbst, supra; Kohn, supra; General Motors, supra.* Andersen may not avail itself of this exception for its contentions here require a determination of issues closely intertwined with the merits of the action. In addition, Andersen's interjection of a request to dismiss the complaint, even though not raised below, further evidences its desire to bring the merits before this Court.

The third factor involves a consideration of irreparable harm to the defendant in terms of the time and money spent in defending the action. A major financial burden in class actions arises from the notice requirement. In *Herbst*, Judge Lumbard was primarily concerned about the defendants' having to share in the cost of notifying the class. However, that is not a factor here as plaintiff is paying the cost of notice.[7] Andersen will spend no unusual sums in defending this action as a class action rather than a private action. In fact, the greatest additional cost has been incurred on this appeal and most certainly could have been avoided by Andersen. If the test is merely that a defendant will have to pay legal fees, then every class determination will be immediately appealable.

7. In addition, the class here is only a small fraction of the size of the Herbst Class, and the cost of notice is estimated to be substantially less.

It is submitted that Andersen presents no such exceptional circumstances here. In *Eisen,* the Court was confronted with unique and extraordinary issues, which did not involve questions that ordinarily arise in determining class status. Andersen's contentions as to adequate representation of the class, and possible conflicts are not comprehended within the *Eisen* rule. Nor do Andersen's other arguments present unique questions for the court to consider. On the contrary, the issues involving the Enabling Act, as well as questions involving due process standards of notice and representation have already been decided, both expressly and impliedly, by the courts. *American Pipe & Construction Co.* v. *Utah,* 414 U.S. 538 (1974); *Eisen,* supra. If this Court accepts Andersen's contention that it is presenting a novel legal argument as a basis for accepting this appeal, then the floodgates will be opened to all enterprising litigants who claim that they too are presenting novel legal arguments when they are in effect rehashing oft determined issues. In such event this Court will be required to decide as a threshold question whether a legal argument is novel before even considering its merits.

Andersen does not meet any of the three criteria necessary for an exception to the final judgment rule.

POINT II

SCOPE OF REVIEW

A. The Trial Court's Exercise of Discretion Should Be Given Great Weight.

Even if this Court accepts jurisdiction of this appeal the trial court's determination with respect to class status may be reversed only upon a showing of abuse of discretion. *City of New York v. International Pipe & Ceramics Corp.,* 410 F.2d 295 (2d Cir. 1969); *Herbst v. International Telephone & Telegraph,* 495 F. 2d 1308, 1316 (2d Cir. 1974); *Appleton Electric Co. v. Advance-United Expressways,* 494 F. 2d 126, 139 (7th Cir. 1974); *Price v. Lucky Stores, Inc.,* 501 F. 2d 1177 (9th Cir. 1974); *Wilcox v.*

Commerce Bank of Kansas City, 474 F. 2d 336 (10th Cir. 1973); *Castro v. Beecher*, 459 F. 2d 725 (1st Cir. 1972); *Hackett v. General Host Corp.*, 455 F. 2d 618 (3rd Cir. 1972) cert. denied 407 U.S. 925 (1972); *Wetzel v. Liberty Mutual Insurance Company*, ____ F. 2d ____(3d Cir. No. 74-1515. Slip Opinion, January 23, 1975).

Rule 23 entrusts the district court with broad discretion in determining whether a case shall proceed as a class action. This was the intention in promulgating the Rule. See, *Frankel, Some Preliminary Observations Regarding Civil Rule 23*, 43 F.R.D. 39 (1967). It has won the support of both courts and commentators.

In *City of New York v. International Pipe & Ceramics Corp., supra*, this Court in discussing the scope of review of a Rule 23 determination stated:

> "In resolving these countervailing situations, the judgment of the trial judge should be given the greatest respect and the broadest discretion, particularly if, as here, he has canvassed the factual aspects of the litigation" at p. 298.

The Third Circuit in *Wetzel v. Liberty Mutual Insurance Company, supra*, affirming certification of a class action stated:

> "Inasmuch as the district court appropriately applied the criteria of Rule 23(a), the scope of our review is whether the district court did abuse its broad discretion." Slip Opinion at p. 6.

The court cited with approval Professor Moore's view that,

> " '...where the trial court does apply the Rule's criteria to the facts of the case, the trial court has [a] broad discretion in determining whether the action may be maintained as a class action and its determination should be given great respect by a reviewing court.' 3B J. Moore, Federal Practice, para. 23.50 at 1104-05" Id., Slip Opinion, at p. 6, n. 6.

The reason for said rule was discussed by the Ninth Circuit in *Price v. Lucky Stores Inc.*, supra,

> "This is so because the district court is in the best position to consider the most fair and efficient procedure for conducting any given litigation. Such a determination by the court will not be disturbed on appeal unless the party challenging it can show an abuse of discretion. Wilcox v. Commerce Bank of Kansas City, 474 F. 2d 336 (10th Cir. 1973); Castro v. Beecher, 459 F. 2d 725 (1st Cir 1972); Hackett v. General Host Corp., 455 F. 2d 618 (3rd Cir 1972); City of New York v. International Pipe & Ceramics Corp., supra." 501 F 2d at 1179.

In this case the District Court was fully apprised of all Andersen's factual contentions and made findings which amply support its holding that class determination is appropriate and superior to any other method of handling this matter. The District Court alone is in the position to continuously reassess its initial decision on a developing record.

B. Issues That Were Not Raised Below Are Improperly Asserted.

Andersen raises several issues which were not raised before the trial court, viz whether the Supreme Court exceeded its authority under the Rules Enabling Act, 28 U.S.C. § 2072, in establishing Rule 23, whether that rule violates the Constitution, and whether Handwerger's action is meritorious.

The general rule is that an order should not be reversed on a point first raised upon appeal, *Palmer v. Reconstruction Finance Corp.*, 164 F. 2d 466, 468 (2d Cir. 1947), *Kappel v. United States*, 437 F. 2d 1222 (3rd Cir. 1971) except under exceptional circumstances, such as the prevention of massive injustice. In *Green v. Brown*, 398 F. 2d 1006 (2nd Cir. 1968), this court relaxed its usual role only because the issues were of great significance in construing an act designed to protect thousands of investors who would be deprived of a remedy in the absence of consideration of the new issue on appeal.

Such exceptional circumstances do not exist here, for consideration of the new issues raised by Andersen are not necessary to protect a large class from injustice. In *Green v. Brown*, supra, the new issue presented apparently was brought forward by a governmental agency that was not a party to the proceedings below. In this case, Andersen was represented by the same counsel below who chose not to make the argument now being made before this court.

As to the merits of Handwerger's claim, Andersen is seeking, in effect, summary judgment without having moved below and with no factual basis. Andersen does not suggest that the pleading itself is insufficient. Andersen offered no affidavit or other evidence below. Andersen is now asking this court to make a determination on the merits, on a Rule 23 motion, contrary to the teachings of *Eisen v. Carlisle & Jacqueline*, 417 U.S. 156, 94 S. Ct. 2140 (1974) and the admonition of this court expressed in *Kohn v. Royall Keogel & Wells, supra,* at page 1100.

POINT III

Importance of Class Actions Under the Federal Securities Acts

As the United States Court of Appeals for the Seventh Circuit observed in *Hohmann v. Packard Instruments Co.*, 399 F. 2d 711 (7th Cir. 1968):

> "To permit the defendants to contest liability with each claimant in a single separate suit would. . .give defendants an advantage which would be almost equivalent to closing the doors of justice to all small claimants. This is what we think the class suit was [intended] to prevent."

Class actions are particularly appropriate in cases where violations of the federal securities laws are involved. *Mills v. Electric Auto-Lite Co.*, 396 U.S. 375, 382 (1970); *J. I. Case v. Borak*, 377 U.S. 426, 432 (1964). See also, Note, *The*

Cost-Internalization Case for Class Actions, 21 Stan. L. Rev. 383, 414-15 (1969). The importance of protecting investors and securing compliance with the securities acts has been at the basis of decisions of this Court and others permitting class actions. *Herbst v. International Telephone & Telegraph*, 495 F.2d 1308 (2nd Cir. 1974), *Green v. Wolf Corp.*, 406 F. 2d 291, 295 (2nd Cir. 1968), *cert den.* 395 U.S. 977 (1969) *Harris* v. *Palm Spring Alpine Estates, Inc.*, 329 F.2d 90[illegible] 9th Cir. 1964); *Esplin* v. *Hirschi*, 402 F.2d 94, 101 (10th Cir. 1968) cert denied 394 U.S. 928 (1969) *Dolgow* v. *Anderson*, 43 F.R.D. 472, 481, 487 (E.D.N.Y. 1968).

As the United States Court of Appeals for the Tenth Circuit held in *Esplin* v. *Hirschi*, 402 F.2d 94 (10th Cir. 1968), *cert den.* 394 U.S. 928 (1969), and as the Court of Appeals for the Third Circuit concurred in *Kahan* v. *Rosenteil*, 424 F.2d 161 at 169 (3rd Cir. 1970), cert den. 398 U.S. 950 (1970)

> " . . *since the effectiveness of the federal securities laws may depend in large measure on the application of the class action device*, 'the interests of justice require that in a doubtful case, such as was presented here when considered by the trial court, *any error, if there is to be one, should be committed, in favor of allowing the class action.* " (emphasis added)

The Securities and Exchange Commission has, also, consistently joined in this view. For example, in an *amicus* brief cited at length in *Dolgow v. Anderson, supra*, the Commission concludes that:

> "Since the enforcement activities of this Commision do not serve to make whole investors who have been injured by a fraudulent course of business and since it is economically impracticable in many instances for investors to pursue available remedies, the representative action seems to provide the most meaningful method by which these claims may be pursued and the Congressional policy favoring such remedies may be vindicated." 43 F.R.D. at 483-84

Private securities litigation such as this is now "commonly determined by means of a class action." *Hawk Industries, Inc.* v. *Bausch & Lomb, Inc.*, 59 F.R.D. 619, 624 (S.D.N.Y. 1973). The

results in practice have been more than satisfactory. The effect of securities class action litigation is assessed as follows in a Report adopted by the Association of the Bar of the City of New York:

> "The precise effect which class actions have had upon the financial community can not be measured. *It is no overstatement that cases such as Escott v. Barchris Construction Corp., 283 F. Supp. 643 (S.D.N.Y. 1968) and Feit v. Leasco Corp., 332 F.Supp 544 (E.D.N.Y. 1971) have had a profound – and beneficial – influence upon the diligence of directors, underwriters, accountants, lawyers and others connected with the public offering of securities" Class Actions, Recommendations Regarding Absent Class Members and Proposed Opt-In Requirements,* Association of the Bar of the City of New York (1973), p. 16 (emphasis supplied).

Effective protection of investors injured by published misrepresentations, and vindication of the public interest in a reliable securities market, require the class action device to succeed.

POINT IV

THERE IS NO CONFLICT BETWEEN PLAINTIFF AND OTHER MEMBERS OF THE CLASS CERTIFIED BELOW.

Andersen does not dispute that the claims made by all members of the class certified by Judge Werker are based upon the same published reports of Sanitas, which were directed to the public at large, and intended to be relied upon by purchasers of all types of Sanitas securities, without distinction. The cause of action asserted on behalf of all members of the class arises similarly out of the same facts, and all class members are tort claimants whose damages were sustained by virtue of the same alleged wrongs. The proof required to establish liability of defendants will be identical as to all members of the class. It will make no difference whether the security purchases which gave rise to the tort claims consisted of debentures or common stock. Accordingly, there will be no conflict in the manner in which discovery will be conducted, in the evidence which will be presented upon trial, or in the manner in which the class members' respective rights to relief will be determined.

Andersen attempts to confuse the question by speaking in terms of differences between debenture *holders* and common stock *holders* in an insolvency proceeding. In point of fact, the class members are not asserting any rights as contract holders or as stockholders, but rather as purchasers of securities who were damaged by the same wrongful acts of the defendants. Whether the measure of damages is awarded on the basis of rescissional, out-of-pocket, or loss of bargain theories, all class members are in the same position.

The only conflict suggested by Andersen is a potential future conflict amongst *defendants*. Andersen's fears that it and the other 18 defendants may be better able to respond to an award of damages to the class than Sanitas creates no conflict among the class members who have a strong common interest in proving the underlying common misrepresentations and omissions and in obtaining judgment against all defendants herein.

This court has already held that potential conflicts which may exist in satisfaction of judgments are not sufficient to bar class treatment. In *Herbst v. International Telephone & Telegraph, supra,* defendants contended that purchasers who sold their stock were in conflict with those who retained it, because the latter had an interest in seeing that ITT remained viable, and might be less likely to diligently pursue such relief. This court rejected that argument, and held that class treatment was appropriate, stating:

> "Furthermore, we do not perceive any conflict of interest between those who have retained their ITT shares and those who have since sold them. The personal interest of those who still hold ITT stock in gaining more from the exchange than they did far outweighs their concern that any award could damage ITT." at p. 1314

While several of the decisions cited by Andersen discussed the "possibility of conflict" between purchasers of debentures and purchasers of common stock, most of them determined that the potential conflict was not yet discernible and did not militate

against determing a combined class. *Fischer* v. *Kletz*, 41 F.R.D. 377 (S.D.N.Y. 1966). *In re Caesar's Palace Securities Litigation*, 360 F.Supp. 366 (S.D.N.Y. 1973) and one of the cases, *Carlisle* v. *L.T.V. Electronics, Inc.* 54 F.R.D. 237 (N.D. Tex 1972) focused upon the manner in which the cause of action arose, which problem does not exist here. Recognizing that distinction, Judge Williams, in *In Re Consolidated Pretrial Proceedings in Ampex Securities Cases*, Docket No. C-72-360 (N.D. Cal. Slip. Opinion April 10, 1974) allowed plaintiff to represent a class consisting of both common and debenture purchasers, even though plaintiff had purchased only common stock, and despite defendant's arguments that Ampex was in precarious straits, stating:

> "Neither does the Court find persuasive defendant's arguments that debenture purchasers and stock purchasers cannot be represented by a shareholder and are in such conflict with plaintiff as to preclude any commonality of the issues. Although it is not unimaginable that purchasers of debentures could be influenced by considerations other than those influencing stock investors, see *Carlisle v. LTV Electronics, Inc.*, 54 F.R.D. 237 (N.D. Tex. 1972), the Court, at this time is not convinced that these differences exist here. The very nature of the positions of these two security holders does not as a matter of law preclude their inclusion in the same class. See *Fischer v. Kletz, supra* at 384; *In re Caesar's Palace Securities Litigation*, CCH Sec. L. Rep. ¶94,005, 94,049."

Andersen's argument ignores the safeguards provided by Rule 23. Unlike other types of actions, the class representative and his attorneys are under the close scrutiny and supervision of the Court directing the litigation. Their actions cannot bind members of the class until a notice is sent to them describing the nature of the action, the damages sought, the contentions of the defendants and informing them that they have a right to appear by their own representative or to alternatively remain as a class member or exclude themselves therefrom. Once such a notice is sent to the prospective class members, they can determine for themselves whether their rights are being protected in the

pending action and if they determine the contrary they can obtain their own representation. No settlement can be effected without notice to the class or without a hearing before the court at which time it is the court's responsibility to determine the fairness, adequacy and reasonableness of the proposed settlement. With all of these safeguards, it is difficult to understand exactly what Andersen is posturing.

Clearly, Andersen has no interest in the successful prosecution of the claims being asserted against it and its present attack can only be seen as disingenuous. While superficially arguing for the best representation of the class, Andersen really attempts to ensure that much of the class will have no representation, thereby avoiding liability.

Other courts have recognized this. In rejecting a similar suggestion of conflict, in *Madonick* v. *Dennison Mines, Ltd.*, 63 F.R.D. 657, 658 (S.D.N.Y. 1974), Judge Metzner perceived defendants' true motives in stating that:

> "Defendants claim that the potential conflict arises from the fact that those shareholders who have retained their shares are not interested in obtaining money damages, since such damages would "seriously" affect Denison's financial condition. In contrast, those who sold their shares are interested only in getting the greatest possible monetary recovery from the corporation. *I must say that defendants' concern that they may not be exposed to the greatest possible liability if plaintiff's motion is granted is indeed touching.* (emphasis added).

This is the only argument presented by Andersen to this Court that was also raised below. Judge Werker considered this issue and in the exercise of discretion found no conflict. As demonstrated in Point II-A supra., such finding should not be overturned unless this Court finds an abuse of discretion.

POINT V.

THE SUPREME COURT DID NOT EXCEED ITS AUTHORITY UNDER THE RULES ENABLING ACT IN ESTABLISHING RULE 23, WHICH IS LIMITED TO PRACTICE AND PROCEDURE.

A. Andersen has not sustained its burden of demonstrating that the Supreme Court exceeded the authority granted it by the Rules Enabling Act 28 U.S.C. § 2072.

There is a strong presumption that the Supreme Court, in adopting Rule 23, acted within the scope of its power. In *Hanna* v. *Plumer*, 380 U.S. 460, 471 (1965) the Supreme Court emphasized the prima facie presumption that its rules are valid by stating:

> "... the court has been instructed to apply the Federal Rule, and can refuse to do so only if the Advisory Committee, this Court, and Congress erred in their prima facie judgment that the Rule in question transgresses neither the terms of the Enabling Act nor constitutional restrictions." at p. 471.

See also *Helms* v. *Richmond-Petersburg Turnpike Authority*, 52 F.R.D. 530,531 (E.D. Va. 1971):

> "28 U.S.C. § 2072 governs the passage of the Rules. This enabling statute specifically states that no Rule is to abridge, enlarge, or modify the substantive rights of any party. Anyone contending that a Rule having been prescribed by the Supreme Court as a rule of procedure is substantive in nature, and a constitutional attack amounts to such a contention, carries a heavy burden. *H.F.G. Co.* v. *Pioneer Pub. Co.*, 162 F.2d 536, 539 (7th Cir. 1947) *A strong presumption exists that the Supreme Court, in prescribing the Rule, acted within the scope of its power*" (emphasis added)

Andersen has failed to rebut the strong presumption that Rule 23 is valid. Of the six cases cited by Andersen for the proposition that "The Supreme Court . . . has invalidated its own rules where they have exceeded the scope of its authority under the Rules Enabling Act (citing six cases), none invalidated a Supreme Court Rule as being in violation of the Rules Enabling Act. (Brief p. 24-25) Four actually upheld the rule in question *Hanna* v. *Plumer*, 380 U.S. 460 (1965) *Sibbach* v. *Wilson & Co.*, 321 U.S. 1 (1941); *J.B. Orcutt Co.* v. *Green*, 204 U.S. 96 (1907); *Hudson* v. *Parker*, 156 U.S. 277 (1895), and the other two are clearly inapplicable here. In *Davidson Marble Co.* v. *Gibson*, 213 U.S. 10 (1909), the Supreme Court did not invalidate its own rule; rather, it struck down a rule promulgated by a circuit court. *Meek* v. *Centre County Banking Co.*, 268 U.S. 426 (1925) is distinguishable also. In that case, the Supreme Court invalidated an order promulgated under the authority of the Bankruptcy Act because an amendment to the Act effected a substantive change inconsistent with the rule. The case, contrary to the manner in which it is cited by Andersen, had nothing to do with the Rules Enabling Act.

In addition, Andersen, does not advise this Court that the Enabling Act expressly required the Rules to be submitted to Congress, so that Congress might veto them if contrary to the policy of the legislature, 28 U.S.C. § 2072, and that Congress' allowing the Rules to take effect is entitled to great weight. *Sibbach* v. *Wilson, supra.*

B. Rule 23 affects only "Practice and Procedure," and does not modify any substantive rights.

The Rules Enabling Act, 28 U.S.C. § 2072, pursuant to which the Supreme Court promulgated the Federal Rules of Civil Procedure, including Rule 23, provides that:

> "The Supreme Court shall have the power to prescribe by general rules, the forms of process, writs, pleadings, and motions, and the practice and procedure of the district courts and courts of appeals of the United States in civil action . . .
>
> Such rules shall not abridge, enlarge, or modify any substantive rights . . . "

In *Sibbach* v. *Wilson, supra,* the Supreme Court stated in regard to an earlier Rules Enabling Act that:

> "The new policy envisaged by the enabling act of 1934 was that the whole field of court procedure be regulated in the interest of speedy, fair and exact determination of the truth." 312 U.S. at 14.

Rule 23 is perfectly tailored to that policy. It insures speedy, economical, and fair determination of the substantive rights of large numbers of persons injured by a prohibited activity, without adding to the substantive rights of the injured, or modifying the defenses of the wrongdoers.

Rule 23 for all its importance relates only "to the manner and means by which a right to recover . .. is enforced," and is therefore within the appropriate scope of the rules of procedure. *See Missisippi Publishing Corp. v. Murphree,* 326 U.S. 438, 446 (1945). Rule 23 does not affect or modify the substantive rights of the parties which, in this case, are established and governed solely by the Securities Exchange Act of 1934, the Rules promulgated thereunder by the Securities and Exchange Commission and common law principles.

It is, of course, impossible to apply any procedural rule without, in some manner, touching upon the substantive law, for as Maitland noted, the substantive law is laid down in the interstices of procedure. Any change in procedure makes it easier or harder for one party or the other, and thus may have a substantial impact upon the *manner* in which said party must enforce his substantive rights; but it does not modify those rights. The Securities Exchange Act under which this action is brought provides the same liabilities and rights with respect to any given set of operative facts whether an action thereunder is brought under Rule 23, or individually. The elements to establish liability remain the same in either event. An omision or misrepresentation must be demonstrated, and its materiality shown. Defendants' culpability must be established by showing that they knew or should have known of the falsity, or recklessly disregarded the truth, or failed to ascertain facts which were

available to them with reasonable effort. In additon, damages must be established. Andersen has failed to demonstrate that Rule 23 changed any of these substantive requirements of the statute under which this suit is brought.

The Supreme Court itself has reviewed actions brought pursuant to Rule 23 and affirmed its validity, under the Rules Enabling Act. *American Pipe & Construction Co.* v. *Utah* 414 U.S. 538 (1974). *See also Eisen* v. *Carlisle & Jacquelin* 417 U.S. 156 (1974). Andersen's argument that Rule 23 alters "substantive" rights and violates the Enabling Act is basically in error because it interchanges the separate and distinct concepts of "substantive" rights and "substantial" impact; in so doing, it ignores *Sibbach*, where the Supreme Court pointed out the significance of the distinction:

> "In order to reach this result she translates 'substantive' into 'important' or 'substantial' rights. And she urges that if a rule affects such a right, albeit the rule is one of procedure merely, its prescription is not within the statutory grant of power embodied in the Act of June 19, 1934." *Sibbach* v. *Wilson, supra,* at p. 11.

In *Mississippi Publishing Corp.* v. *Murphree*, 326 U.S. 438, 445-446 (1946), the Supreme Court authoritatively rejected broad arguments that would hamstring the Courts and call into question many of the Federal Rules of Civil Procedure. The court held that:

> "Undoubtedly most alterations of the rules of practice and procedure may and often do affect the rights of litigants. Congess' prohibition of any alteration of substantive rights of litigants was obviously not addressed to such incidental effects as necessarily attend the adoption of the prescribed new rules of procedure upon the rights of litigants who, agreeably to rules of practice and procedure, have been brought before a court authorized to determine their rights. *Sibbach* v. *Wilson & Co.* 312 U.S. 1, 11-14. *The fact that the application of Rule 4(f) will operate to subject petitioner's rights to adjudication by the District Court for Northern*

Missisippi will undoubtedly affect those rights. But it does not operate to abridge, enlarge or modify the rules of decision by which that court will adjudicate its rights. It relates merely to the manner and the means by which a right to recover . . . is enforced." (emphasis supplied)

Accord: *Hanna* v. *Plumer* 380 U.S. 460 (1965); *Sibbach* v. *Wilson, supra.*

In *American Pipe & Construction Co.* v. *Utah, supra,* defendants specifically raised the question of whether application of Rule 23 modified substantive law overreaching the authority granted to the Supreme Court in the Rules Enabling Act. The action was brought under Federal antitrust laws, and involved application of the statute of limitations which was contained in and was an inherent part of the statute sued under. The action was commenced pursuant to Rule 23, but subsequently the trial court determined that the suit could not be maintained as a class action. The issue was whether commencement of the action tolled the running of the statute of limitations for *all* members of the purported class until entry of the order denying class action status. Defendants contended that any such tolling of the statute of limitations, which was an inherent part of the statute sued under, was a modification of substantive rights and liabilities under the statute, and thus was unauthorized under the Rules Enabling Act. The Supreme Court rejected this contention, despite defendants' argument that such construction would enlarge the period during which they could be held liable for their actions.

In so holding the court made the interesting observations that "The proper test is not whether the time limitation is 'substantive' or 'procedural,' but whether tolling the limitation in a given context is consonant with the legislative scheme." *American Pipe Construction Co., supra,* 414 U.S. 538, 94S. Ct. 56, CCH Trade Cases ¶74,862 at 95,841. The "legislative scheme" behind the Federal Securities Acts was the protection of all investors. The procedural availability of a class action whereby a small investor can take up the cudgels against a giant wrongdoer is clearly "consonant with the legislative scheme."

Just as application of Rule 23 to enlarge the time limitation contained in a federal statute providing for substantive liability does not violate the Enabling Act, neither does an application of Rule 23 here where there is no change in the substantive provisions of the Securities Exchange Act, upon which this action is based.

C. The 1966 Revision of Rule 23 did not affect substantive rights.

As explained by Mr. Justice Stewart in *American Pipe & Construction Co.* v. *Utah, supra,* Rule 23, prior to its 1966 Amendment, was unfair to defendants because its potential for so-called "one-way intervention" allowed members of a class to benefit from a favorable judgment without subjecting themselves to the binding effect of an unfavorable one. He stated that the "1966 amendments were designed, in part, specifically to mend this perceived defect in the former Rule and to assure that members of the class would be identified before trial on the merits and would be bound by all subsequent orders and judgments." 414 U.S. 538, 94 S.Ct. 56, CCH Trade Cases ¶74,862 at 95,837.

Although such amendment was designed to protect parties defendant such as Andersen, Andersen now complains that the protection given to it from a formerly unfair procedural device modifies the substantive law because of its *res judicata* and collateral estoppel effects. Andersen's entire argument is premised upon the doctrine of *Erie R. Co.* v. *Tompkins,* 304 U.S. 64 (1938) (brief pages 28-31) and cites only diversity cases in support. However, the Supreme Court has expressly stated that the *Erie* argument is irrelevant. In *Hanna* v. *Plumer, supra,* the court was considering whether one of the federal rules violated the provision of the Rules Enabling Act relating to modifications of substantive law. Speaking for the court, Chief Justice Warren stated:

> "There is, however a more fundamental flaw in respondent's syllogism: the incorrect assumption that the rule of *Erie R.*

Co. v. *Tompkins,* constitutes the appropriate test of validity and therefore the applicability of a Federal Rule of Civil Procedure. *The Erie rule has never been invoked to void a federal rule.**** [In] cases adjudicating the validity of Federal Rules, we have not yet applied the York rule or other refinements of Erie, but have to this date continued to decide questions concerning the scope of the enabling act and the constitutionality of specific Federal Rules in light of the distinction set in *Sibbach.* (380 U.S. 470-471) E.g. *Schlagenhauf* v. *Holder,* 379 U.S. 104, 85 S.Ct. 234, 13 L.Ed.2d 152.

Nor has the development of two separate lines of cases been inadvertent. The line between "substance" and "procedure" shifts as the legal context changes. "Each implies different variables depending upon the particular problem for which it is used." *Guaranty Trust Co. of New York v. York, supra,* 326 U.S. at 108, 65 S.Ct. at 1469; Cook, The Logical and Legal Basis of the Conflict of Laws, pp. 154-183 (1942). It is true that both the Enabling Act and the Erie Rule say, roughly, that federal courts are to apply state "substantive" law and federal "procedural" law, but from that it need not follow that the tests are identical. For they were designed to control very different sorts of decisions. When a situation is covered by one of the Federal Rules, the question facing the court is a far cry from the typical, relatively unguided Erie choice: the court has been instructed to apply the Federal Rule, and can refuse to do so only if the Advisory Committee, this Court, and Congress erred in their prima facie judgment that the Rule in question transgresses neither the terms of the Enabling Act nor unconstitutional restrictions. 380 U.S. at 469-471. (emphasis supplied)

The test which Justice Warren referred to, in *Hanna,* found in *Sibbach* v. *Wilson, supra,* stated:

"The test must be whether a rule really regulates the procedure—the judicial process for enforcing rights and duties recognized by substantive law and for justly administering

remedy and redress for disregard or infraction of them." (312 U.S. at 14)

Rule 23 merely provides the "judicial process for enforcing rights and duties [of plaintiff and members of the class] recognized by substantive law [in this case, §10(b) of the Securities Exchange Act] and for justly administering remedy and redress for disregard or infraction of them.", by providing a mechanism whereby class members' rights can be enforced by giving them adequate representation and proper notice as described in *Eisen* v. *Carlisle & Jacquelin, supra.* Such a mechanism is no different, in concept, from the federal rules relating to service of process, whereby defendants may be brought into a case to have their substantive liabilities litigated by means of the notice (service of process) provisions of the Federal Rules. Such procedural devices have consistently been upheld as within the scope of the Rules Enabling Act. *Mississippi Pub. Corporation* v. *Murphree,* 326 U.S. 438 (1946); *Hanna* v. *Plumer, supra.*; *United States* v. *Montreal Trust Co.*, 35 F.R.D. 216 (S.D.N.Y. 1964).

Andersen concedes in its brief (at page 30) that "binding unknown and unidentified persons to a judgment is not a novel concept in the law . . . " and that jurisdiction could be obtained over such persons ". . . where a statute providing a constitutional method of procedure has been followed . . . ". The very authority cited by Andersen supports Handwerger's position that the jurisdiction Rule 23 provides is procedural rather than substantive. Andersen's concern that the mechanics of such procedure be constitutional ignores the Supreme Court finding in *Eisen* v. *Carlisle & Jacquelin, supra,* that the mechanics of Rule 23 are constitutional if adequate notice is given. Accordingly, it is respectfully submitted that Rule 23, which does not alter traditional doctrines of judicial procedure, much less substantive rights, is well within the authorization granted to the Supreme Court in the Rules Enabling Act.

POINT VI

THE REQUIREMENT OF NOTICE AND ADEQUACY OF REPRESENTATION SET FORTH IN RULE 23 COMPLY WITH THE DUE PROCESS PROVISIONS OF THE CONSTITUTION

A. Notice Requirement of Rule 23.

The Supreme Court in *Eisen* v. *Carlisle & Jacquelin, supra,* measured the notice requirement of Rule 23 against the Constitutional standards of due process and found it sufficient. The Court recognized the traditional concept that "notice and an opportunity to be heard were fundamental requisites of the Constitutional guarantee of procedural due process." 94 S.Ct. at 2151. With that in mind, the Court held that the notice requirement of Rule 23(c)(2) fulfilled this fundamental requisite.

In the *In Re Four Seasons Securities Laws Litigation,* 502 F.2d 834, 842-44 (10th Cir. 1974), the Tenth Circuit recently gave effect to a class action settlement, precisely because the class members who claimed conflicting interests had been afforded notice of the settlement and of their opportunity to exclude themselves from the class. In holding that due process requirements were satisfied, the Court stated:

> "The touchstones of due process in class actions have always been notice and adequacy of representation, but their interrelationship has never been completely and clearly articulated . . . .
>
> "The landmark due process decision in class action law is *Hansberry v. Lee,* 311 U.S. 32, 61 S. Ct. 115, 85 L.Ed. 22. In that case the Supreme Court refused to give *res judicata* effect to a state court decision against certain ostensible class members who have not received notice and had not been adequately represented . . . .
>
> "In 1966 class action procedures were revised under Rule 23(c) (2) with respect to actions, such as the instant one,

brought under Rule 23(b)(3). Recognizing the unique availability of exclusion under 23(b)(3) actions, the revised rule requires that the best practicable notice under the circumstances be sent to the members of the class advising them of their right to opt out or to enter an appearance in the action through counsel. The resulting judgment, whether favorable or not, will bind all members who then fail to exercise the option to be excluded. . . .

"We are constrained to conclude that due process was satisfied here when Ohio received the notice and order delineating the terms of the proposed settlement and informing Ohio that it was a designated member of a class, that it had the opportunity to opt out or be represented by counsel, that it would be bound if it failed to opt out. In such a case, we conclude that due process may be satisfied by notice alone and that, where due process is thus satisfied, adequacy of representation need not be shown as a matter of constitutional necessity."

Greenfield v. *Villager Industries, Inc.*, 483 F.2d 824 (3rd Cir. 1973) found that the notice ordered by the trial court was improper, but reaffirmed the constitutionality of the standard set forth by Rule 23. The Court stated:

"A procedure such as the class action . . . can comport with constitutional standards of due process only if there is a maximum opportunity for notice to the absentee class members, i.e., '[T]he best notice practicable under the circumstances including individual notice . . . '" at 831.

It is for the lower courts to decide, on a case by case basis, whether the application of this standard complied with due process.

The suggestion of Andersen[8] that the notice provisions of Rule 23 must take up four printed pages dealing with every imaginable specific situation is absurd. The Constitutional

8. Brief p. 40

requirements of due process are met through application of general principles rather than the enunciation of narrow strictures which cannot possibly consider each and every possible future application.

B. Adequacy of Representation Requirement of Rule 23.

Andersen does not argue that the requirement of Rule 23 that a class representative adequately represent the interests of the class members violates the due process requirements of the Constitution. Rather, Andersen makes a factual argument that Handwerger is not a real, bona fide plaintiff, having an actual personal stake in the action and a personal interest in its outcome. Andersen, which grosses more than $300 million a year, may feel that the loss of $5,000 is so nominal that Handwerger has no real interest in the outcome of this litigation. That is simply not the case. Indeed, Andersen in reality is employed by the Handwergers of this world, to protect them against losses such as sustained here. Andersen is not content to merely attack Handwerger, it attacks any smaller investor who has the temerity to assert his rights as a class representative against persons alleged to have violated the federal security laws.

Andersen ignores that the very purpose of Rule 23 was to provide a procedural mechanism whereby persons with limited resources would be enabled to have their claims considered by the Federal Courts on their merits. As this court so aptly stated in *Escott* v. *Bachris Construction Corporation*, 340 F. 2d 731, 733 (2d Cir. 1965), *cert. den.* 382 U.S. 816 (1966):

> "In our complex modern economic system where a single harmful act may result in damages to a great many people there is a particular need for the representative action as a device for vindicating claims which, taken individually, are too small to justify legal action but which are of significant size if taken as a group. In a situation where we depend on individual initiative. . . of lawyers, for the assertion of rights, there must be a practical method for combining these small

claims, and the representative action provides that method. The holders of one or two of the debentures involved in the present action could hardly afford to take the risk of an individual action. The usefulness of the representative action as a device for the aggregation of small claims is 'persuasive of the necessity of a liberal construction of...Rule 23.' *Weeks v. Pareco Oil Co.*, 125 F.2d 84 (7th Cir. 1941); and see generally *Kalven and Rosenfield*, The Contemporary Function of the Claim Suit, 8 Univ. of Chic. L. Rev. 684 (1941)". [Footnote omitted]

Judge Weinstein made the same point in *Dolgow v. Andersen*, 43 F.R.D. 472, 495 (E.D.N.Y. 1968) where he stated:

"[t]o assert that the minute interests of the parties before the court is a factor which militates against allowing a class action is to ignore the spirit of Rule 23...[I]f the plaintiff's claim is very large a class action is rendered unnecessary, the main purpose of the class action is to provide a means of vindicating small claims. It would be anomalous to hold that only major financial interests can make use of it."

Recently this Court in *Herbst* v. *ITT*, *supra*, affirmed Mrs. Herbst as an adequate class representative notwithstanding the fact that her personal stake was nominal, being 100 or 200 shares.

Benjamin Kaplan[9] who was Reporter to the Advisory Committee during the 1966 revision of Rule 23 identified two purposes underlying its revision:

"The entire reconstruction of the Rule bespoke an intention to promote more vigorously than before the dual missions of the class-action device: (1) to reduce units of litigation by bringing under one umbrella what might otherwise be many separate but duplicating actions; (2) even at the expense of

9 Benjamin Kaplan is now a Justice of the Supreme Judicial Court of Massachusetts and was at the time he served as Reporter a professor at the Harvard Law School.

increasing litigation, to provide means of vindicating the rights of groups of people who individually would be without effective strength to bring their opponents into court at all." Kaplan, A Prefatory Note, 10 B.C. Ind. & Comm. L. Rev. 497 (1969).[10]

Of course, these purposes obtained before the revision as well. See e.g., *Weeks v. Bareco Oil Co.*, 125 F.2d 84, 88-90 (7th Cir. 1941); *Montgomery Ward & Co., Inc. v. Langer*, 168 F.2d 182, 187 (8th Cir. 1948)."[11]

Disinterested and learned commentators have applauded both the promise and the operation of Rule 23 in fairly and efficiently securing relief from serious violations of law affecting numerous persons. E.g., Committee on Commerce, United States Senate, Class Action Study; Hazard, The Effect of the Class Action Device Upon the Substantive Law, 58 F.R.D. 307; Homburger, State Class Actions and the Federal Rule, 71 Colum. L. Rev. 609 (1971); Miller, Problems in Administering Judicial Relief in Class Actions Under Federal Rule 23(b)(3), 54 F.R.D. 501.[12]

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10 See, also, Kaplan, Continuing Work of the Civil Committee: 1966 Amendments of the Federal Rules, 81 Harv. L. Rev. 356, 397-398 (for "small claims held by small people" the (b) (3) action intentionally "serves something like the function of an administrative proceeding". ..The Alternative of treating such claims and persons "as null quantities is questionable").

11 See also, Smith v. Swormstedt, 57 U.S. 288, 303 (1853); "For convenience, therefore, *and to prevent a failure of justice*, a court of equity permits a portion of the parties in interest to represent the entire body, and the decree binds all of them as if all were before the court." (Emphasis added).

12 Professors Hazard, Homburger and Miller are, respectively, members of the law faculties at Yale, the State University of New York at Buffalo, and Harvard; Professor Miller is co-author of Wright and Miller, Federal Practice and Procedure.

POINT VII

THIS COURT SHOULD NOT DISMISS THIS ACTION WHEN SUCH RELIEF WAS NOT REQUESTED BELOW, WHEN THERE IS NO RECORD ON THAT POINT, AND WHEN THE ACTION CLEARLY SETS FORTH MERITORIOUS CLAIMS.

Andersen improperly characterizes the wrongs alleged in the complaint as being solely whether there was adequate disclosure of whether the partnership purchasing Economy was a limited partnership or a general partnership. While it is undisputed that the September 21, 1972 letter did not disclose that the purchaser was a limited partnership, and that the 1972 Annual Report did not disclose that the purchaser was a limited partnership, Andersen urges this appellate tribunal to make a factual determination that a reference to the partnership buried at the end of a separate document, Sanitas Proxy Statement, cured the prior misrepresentation and omission. No evidence or argument was submitted to the court below on this point nor is there any record before this court on this point.

Even more significant is the fact that Andersen has misconstrued the thrust of the complaint herein. Whether the purchaser was a limited partnership or a general partnership is only one of the many factual issues raised in the complaint. Others include (1) whether the sale of Economy was a sham transaction, (2) whether defendant's representations that the adverse financial effects of Economy on Sanitas had been eliminated were false and misleading statements; (3) whether the 1972 Financial Statements of Sanitas,[13] which listed Economy as being an asset in the amount of $2,616,569 (apparently because of the agreement to sell Economy in the future for that price) was a fair presentation of the value of Economy; (4) whether Sanitas' real estate and property related to Economy was fairly carried on the financial statements of Sanitas or should have been written down to its true value; (5) whether the monies due from the partnership with respect to the Economy "sale" were reasonably

13. Certified by Andersen.

expected to be collectible. There are many other issues bearing upon the effect of the Economy transaction and the accuracy of other aspects of Sanitas Financial Statements and reports.

Andersen's role in the entire transaction is in issue. The complaint alleges that Andersen participated or aided and abetted in the issuance of the false reports and that Andersen knew or should have known the falsity thereof. Although it does not appear in the record, for dismissal was not urged by Andersen below, discovery already conducted has established that Andersen rendered accounting and tax advice to both Sanitas and the partnership and thus assisted in formulating the entire transaction.

All the allegations of the complaint must be taken as true on any motion to dismiss under Rule 12. A motion to dismiss, if that is what this is, for failure to state a claim cannot be granted

> ". . .unless it appears to a certainty that plaintiff is entitled to no relief under any state of facts which could be proved in support of his claim." *Jennings* v. *Patterson*, 460 F.2d 1021 (5th Cir. 1972); Moore's Federal Practice, §1208; *Conley* v. *Gibson*, 355 U.S. 41, 45-46 (1957).

If it is a summary judgment motion, factual issues require its rejection, particularly because Andersen has submitted no evidence whatsoever to rebut the allegations of the complaint with respect to it.

CONCLUSION

This court should decline to accept jurisdiction over this appeal which is not from a final order. In order to expedite the appellate process, this court should also advise the court below that it would decline to accept jurisdiction of an appeal even if §1292(b) certification were given to the order below.

If this court accepts jurisdiction of the appeal, the well reasoned decision below conditionally granting class determination should be affirmed.

Dated: New York, New York
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Respecfully submitted,
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